BEFORE THE
CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

In the Matter of:

RICHARD D. KRUGLOV
(Petitioner)

PRECEDENT
TAX DECISION
No. P-T-105
Case No. T-70-37

JOHN L. COLONNA
(Respondent)

RE: COLONNA'S CANTINA
Employer Account No.

DEPARTMENT OF HUMAN
RESOURCES DEVELOPMENT

The petitioner, Richard Kruglov, has appealed from Referee's Decision No. LA-T-3092 which denied his petition for reassessment. Concurrently with the filing of his appeal, he paid the employer contributions assessed in the amount of $139.05 and the employee contributions assessed in the amount of $51.50. He did not, however, pay any portion of the balancing tax, penalties, or interest assessed.

STATEMENT OF FACTS

In May of 1967, the petitioner, Richard Kruglov, and the respondent in these proceedings, John L. Colonna, formed a partnership for the purpose of operating a restaurant known as Colonna's Cantina. It appears that it was their intention at that time to form a limited partnership and that the petitioner should be a limited partner. In furtherance of their business intentions, they took certain steps.

Under date of May 23, 1967, they executed a form entitled "Certificate of Business, Ficticious Name," in which they certified that they were conducting a limited partnership under the ficticious firm name of Colonna's Cantina. In stating the composition of the firm, the

certificate identified the petitioner as "limited partner." The evidence does not indicate whether this certificate was ever filed with the county clerk and published in a newspaper in accordance with the provisions of Civil Code section 2466.

Under date of May 24, 1967, petitioner and respondent entered into a written partnership agreement in which they stated their intention of forming a limited partnership under the laws of this state to be known as "Colonna's Cantina, Ltd." for various enumerated purposes sufficiently broad to include the operation of a restaurant. The term for which the partnership was to exist was stated as the period from the beginning of business on May 22, 1967 until the close of business on June 30, 1968, and thereafter from year to year unless a majority of the partners voted to terminate the business. The share of each partner in the profits and losses of the partnership was stated to be 50 percent with an overall limitation of $2,500 on the amount of losses to be borne by the petitioner who was identified as a limited partner.

The partnership agreement contains most but not all of the statements required to be set forth in a certificate for the formation of a limited partnership under the provisions of Corporations Code section 15502. The copy of this agreement in evidence bears no acknowledgment. No certificate of limited partnership was ever filed in the county clerk's office or recorded in the county recorder's office as required by the provisions of Corporations Code section 15502 in connection with the formation of a limited partnership.

Around June 9, 1967, a registration form signed by John L. Colonna was filed with the Department for an employing unit operating under the business name of Colonna's Cantina. The form indicated that the owners of the business enterprise were John L. Colonna and Richard Kruglov. It showed the beginning date of the business as June 12, 1967.

An application for an on sale beer and wine license was made to the Alcoholic Beverage Control Department by Colonna and Kruglov. While the application was pending, they jointly submitted the following statement to that department under date of June 23, 1967:

"Pursuant to your request we are hereby confirming that it was originally our intent to operate the business known as 'Colonna's Cantina' as a limited partnership however, due to circumstances which have arisen since formulation of our original plans, we now intend to carry on the business as a general partnership."

The petitioner, Kruglov, explained the submission of this statement in the following way: When the original application was made out, the clerk left out the word "limited" when he designated the applicant as a partnership. When this omission was discovered, it would have required the submission of a new application to have obtained a license on a limited partnership basis. This would have resulted in about a 90-day delay in obtaining the license.

According to Kruglov, the representative of the Alcoholic Beverage Control Department told him that that department did not like to issue a license on a limited partnership. The representative indicated that the partners could change their intent without changing their relationship. So, they submitted the statement in order to obtain the license under the pending application, without intending that he and Colonna would thereafter have a general partnership.

On July 5, 1967, an on sale beer and wine license was issued by the Alcoholic Beverage Control Department to J. L. Colonna and Richard D. Kruglov doing business as Colonna's Cantina at the restaurant premises. The license was issued in the form used for recording the licensee as a general partnership. This is a different form from that used for recording the licensee as a limited partnership.

Under date of July 18, 1967, the petitioner, Kruglov, and the respondent, Colonna, executed a written amendment to their partnership agreement of May 24, 1967. Among other things this amendment changed their respective shares in partnership profits and losses to 98 percent for Kruglov and 2 percent for Colonna. Except for the changes made, the amendment confirmed the continuation of the terms and conditions of the original agreement.

It is not possible from the evidence to identify the exact date upon which the restaurant commenced operation, but it appears to have been sometime during the month of May in 1967 after an extended period of preparation filled with much frustration and delay. In the beginning, the respondent, Colonna, functioned as the cook. Later there was also another cook, a Mr. Lori, who was remunerated by way of a precentage of the restaurant's gross business.

In addition, from the beginning of operations, there was a cleanup man, Jose Baldomgro, and at least one waitress employed at the restaurant. On rare occasions there may have been more. Because of the very rapid turnover of waitresses, many different individuals were so employed. The cleanup man was paid $50 to $60 per week. The waitresses worked for wages plus tips.

Kruglov took care of certain maintenance work at the restaurant. Together, he and Colonna took care of the greeting of customers, buying of fixtures and supplies, and the bookkeeping. According to Colonna, Kruglov, an accountant by profession, was at the restaurant a substantial number of hours each day, but not usually at one continuous stretch. He was in and out.

The restaurant did not prosper and no profits were ever realized out of the operation of the business. The amendment of the partnership agreement on July 18, 1967 was apparently made because Colonna was not willing to continue to cook and operate the restaurant on a share of profits basis. Colonna asserted that he did not work in the restaurant after that date or at most more than a few days after it. According to his testimony, he turned the restaurant over to Kruglov who continued to operate it through Mr. Lori.

Kruglov, on the other hand, testified that Colonna, after a short vacation around this time, returned to the restaurant and continued to be in and out of it until about November or December of 1967, and particularly that Colonna was very active in certain events that were put on at the restaurant in the latter part of September, 1967. Apparently, Mr. Lori was present in the restaurant during this period, but to a lessening degree as he became involved in outside activities. Sometime in November or December of 1967, the plumbing gave way in the motel in which the restaurant was located, and the ceiling of the restaurant caved in. For a period of time, thereafter, it was not operative.

The extent to which the petitioner, Kruglov, participated in the operation and management of the restaurant prior to this cave in is not clear from the evidence. He does admit that he did some direct work running the restaurant for about a week while Mr. Lori had the flu. According to the petitioner, this consisted for the most part of serving beer. When the ceiling caved in, Mr. Lori reported the event to the petitioner.

In general, the petitioner, like the respondent Colonna, disclaimed direct knowledge of who was really operating the restaurant during this period. In the conflict of their testimony, each would place the other in charge primarily through Mr. Lori. Clearly, Mr. Lori was not in charge upon his own behalf.

Just when the restaurant reopened after the cave in, is not clear from the evidence. The respondent, Colonna, disclaimed any knowledge of its operation until sometime in March of 1968. The petitioner, Kruglov, asserted that it was not in operation at all until that time.

Colonna had a friend by the name of Joe Castimonti, a jukebox operator, who had equipment in the restaurant. Sometime in March of 1968, Castimonti called Colonna to tell him that the restaurant was closed down. Castimonti wanted to get it back into operation by placing his friend, Gerald J. Castellaw in it to manage it. Colonna did not know Castellaw, but wanted to help his friend Castimonti get back his money.

So, Colonna conferred with Kruglov to try to get his consent to let Castellaw manage the restaurant, but Kruglov refused. Colonna then signed a letter on March 21, 1968 stating that as of that date, Gerald J. Castellaw was in his employ as manager of the place. About March 31, 1968, Kruglov went to the premises and found the business open and being operated by Castellaw.

Kruglov attempted to get the books and records of the restaurant and take the Alcoholic Beverage Control license off the wall. He was thrown out through a plate glass window. A day or two later, he requested the Alcoholic Beverage Control Department to rescind the license. The records of that department indicate that the license was surrendered under its Rule 65 of April 1, 1968, and later revoked on February 15, 1969 for nonrenewal.

Just how long the restaurant continued to be operated after these events and by whom is not clear from the evidence, except that it was not operated beyond May 14, 1968. On that day, the motel in which the restaurant was situated was foreclosed. All of the physical assets of the restaurant including the books and records disappeared.

The petitioner, Kruglov, however, did find a payroll book among some papers that he salvaged from the premises around that time. He later turned this book over to the Department auditor who prepared a schedule of wages paid by Colonna's Contina during the third and fourth quarters of 1967 as reflected in this book. There are no payments reflected as having been made after the week ending November 19, 1967.

Payments are shown as having been made to some 16 different persons in the aggregate amount of $2,670.05 during that period. $2,017.16 of wages are shown as having been paid in the third quarter of 1967 and $652.89 are shown as having been paid in the fourth quarter of that year. Nearly half of all of the wage payments shown for the third quarter are indicated as having been made to the cleanup man, Jose Baldomgro. There are nc payments shown to the cook, Mr. Lori, nor to Mr. Castellaw.

An unsigned contribution return was filed upon behalf of the employing unit, Colonna's Cantina for the period extending from June 12, 1967 to June 30, 1967 indicating that no wages were paid during that period. No returns were filed for any other period. On May 24, 1968, the Department made an assessment against the respondent, John L. Colonna, for contributions claimed on an estimated and unreported wages paid in connection with the operation of Colonna's Cantina during the period from July 1, 1967 to March 12, 1968.

The estimate was based on wages of $75 a week paid to two employees throughout the period of the assessment, allowing for an alleged closure of the business for several weeks in the fourth quarter of 1967. The assessment was made on an estimated basis in the absence of any known books or records. At that time, the Department did not know of the existence of the payroll book which the petitioner, Mr. Kruglov, later turned over to it.

The respondent, Colonna, did not petition for reassessment of the assessment which the Department made against him. The time for filing any such petition expired prior to August 1, 1968. The assessment against Colonna is not under review in these proceedings.

The Department attempted to collect the assessment against Colonna without any success. On October 7, 1968, it made an assessment against the petitioner, Kruglov, in the same amount and upon the same basis for wages paid in connection with the operation of Colonna's Cantina during the same period. Under signature date of October 8, 1968, and a notary's date of October 9, 1968, Kruglov made an affidavit which was published in the Los Angeles Daily Journal on October 11, 1968, stating the following:

> "I, Richard D. Kruglov, renounce my interest in the profits of and/or other compensation by way of income from the Limited Partnership known as COLONNA'S CANTINA, formerly located at 5270 Sunset Blvd., Los Angeles, California. I am not liable for nor bound by the debts or obligations of the business, the partnership, or the partners thereof."

The Department's assessment against Kruglov was made upon the basis of its conclusion that he was a general partner in the operation of Colonna's Cantina, and thus liable as such for the contributions claimed. Kruglov petitioned for reassessment of this assessment upon the basis that he was a limited partner in the business, and as such is not liable for any assessments against or obligations of it. He also contended that the assessment was excessive and included an estimation of wages for a period during which the business had no employees to his knowledge.

By way of the appeal now before us for review of the referee's denial of the petition, Kruglov stresses particularly:

(1) that taxes were levied for a period of time during which the business did not operate;

(2) that penalties and interest should not be levied against him personally;

(3) that he knows of no such tax as a balancing tax; and

(4) that there has been unequal application of the Department's efforts in pursuing collection against himself as against Colonna.

The respondent, Colonna's status in these proceedings is solely that of a respondent to the petition of Kruglov in regard to the assessment against Kruglov. The issue to be resolved is solely that of the liability of Kruglov for the assessment under review.

REASONS FOR DECISION

The Unemployment Insurance Code makes special provision in section 1179.5 for the transformation of a petition for reassessment into a petition for review of denial of claim for refund when the assessment is paid during the pending of such a petition either before a referee, or on appeal to this board. However, those provisions only come into operation when the amount of contributions, penalties, and interest assessed has been paid. In the case of a petition pending on appeal, the payment must be made before the Appeals Board issues its decision on such appeal.

The petitioner, Kruglov, has paid the amount of employer and employee contributions assessed, but he has not as of this time paid the amount of balancing tax, penalties, and interest. His partial payment is not sufficient to bring the provisions of code section 1179.5 into operation. The petition before us, therefore, is and remains a petition for reassessment filed under the provisions of code section 1133, and our review is of an appeal from a decision on such a petition under code section 1134.

In a reassessment proceeding, we do not have jurisdiction to order the refund of any payments made by the petitioner, even if our decision upon the petition should lead to the conclusion that a refund is in order. Such a refund can only be obtained under such circumstances in refund proceedings initiated by the filing of a claim for refund with the Department under the provisions of code sections 1178 and 1179. In such a proceeding, a determination can be made as to whether any amount of contributions, penalty, or interest has been erroneously or illegally collected in excess of the amount legally due, and in excess of any other amounts then due or accrued against the employing unit, and the balance can be ordered refunded.

Liability for penalty in regard to an assessment made under code section 1126 is mandatory. If the Department makes an assessment under that section, it must add a penalty of 10 percent to the amount of employer and worker contributions that it computes and assesses upon the basis of its estimate of the amount of wages paid for employment. Liability for the penalty, thus, stands or falls, with the contribution liability itself.

The same is true of liability for interest under code section 1128. It automatically accrues on the contribution liability for each month, or fraction thereof, that payment is delayed from the time that the contributions should have been paid until they actually are paid. Again, liability for interest stands or falls with the contribution liability itself.

Since we have no jurisdiction in a reassessment proceeding to order refund of any contributions that have been paid, the payment of the full amount of contributions assessed would normally make any further consideration of the matter moot. This is the basic reason for the provisions of code section 1179.5, so that the proceedings can go forward to an effective conclusion on a refund issue when payment is made during their progress. In this case, however, while the petitioner has paid the full amount of employer and employee contributions, he has not paid the balancing tax levied under the provisions of code section 976.5. Since liability for this tax is based upon the same wages paid for employment, the question of the petitioner's liability is not moot, and we may properly proceed to consider the issues he has raised in regard to his contribution liability.

The evidence clearly reflects that the petitioner, Kruglov, and the respondent, Colonna, intended to form a partnership for the operation of the business known as Colonna's Cantina. The only question in this regard arises as to whether they intended to form their partnership under Corporations Code section 15502, and if so whether they succeeded in accomplishing this. Substantial compliance with that section is essential in order to create a limited partnership in this state, and to bring into operation the basic principle of limited liability expressed in Corporations Code section 15501 that: "The limited partners as such shall not be bound by the obligations of the partnership."

This, of course, does not mean that a partnership cannot be formed in which the partners agree among themselves that one (or more) of their number shall have a right to contribution from the others for anything that he may be compelled to pay in satisfaction of the obligations of the partnership beyond some specified limit. Unless, however, there has been substantial compliance with Corporations Code section 15502 in the formation of the partnership, the liability of such a "limited" partner to the outside creditors of the partnership is as stated in Corporations Code section 15015, that:

> "All partners are liable
>
> "(a) Jointly and severally for everything chargeable to the partnership under Sections 15013 and 15014.
>
> "(b) Jointly for all other debts and obligations of the partnership; . . ."

Even, however, when a partnership is formed by substantial compliance with Corporations Code section 15502, a limited partner may still become liable as a general partner, if he participates in the control of the business by exercising rights in excess of those permitted to a limited partner under the law. The shield of limited liability arising out of the formation of the partnership, may be lost in the manner of operation of its business. We may, therefore, have to consider whether Kruglov's participation in the operation of Colonna's Cantina was such as to make him liable as a general partner under the provisions of Corporations Code section 15507 which states that:

> "A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."

It may also happen that a person contributes to the capital of a business erroneously believing that he has become a limited partner in a limited partnership. If upon ascertaining his mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income, he is not a general partner with the person carrying on the business by reason of his exercise of the rights of a limited partner. Under such circumstances, he escapes liability for the obligations of such person under Corporations Code section 15511. Under this provision we may be called upon to

consider the effect of the petitioner Kruglov's renunciation of his "interest in the profits of and/or other compensation by way of income from the Limited Partnership known as COLONNA'S CANTINA" published in the Los Angeles Daily Journal on October 11, 1968.

Let us consider the actions of the parties in the light of the foregoing. In a form executed under date of May 23, 1967 entitled "Certificate of Business, Ficticious Name" Kruglov and Colonna certified that they were conducting a limited partnership. Likewise, in their written partnership agreement entered into under date of May 24, 1967, they expressly stated their intention of forming a limited partnership under the laws of this state.

Thus, if we may take Kruglov and Colonna at their word, it appears clear that as of the time of the formation of the partnership, it was their intention that Kruglov should be only a limited partner. However, the mere expression of such an intention or the designation of such a status even in written papers is not alone a sufficient act to limit the liability of a partner to outside creditors of the partnership. As we have pointed out above, a limited partnership is formed under the laws of this state only if there has been substantial compliance in good faith with the requirements of Corporations Code section 15502. (J. C. Watterburger & Sons v. Sanders (1961), 191 Cal. App. 2d 857 at page 862, 13 Cal. Rptr. 92 at page 94)

That section requires that two or more persons desiring to form a limited partnership must file a signed and sworn certificate in both the county clerk's office and the county recorder's office. The certificate so filed must set forth certain information prescribed in this statute. Altogether, it details some fourteen items of information about the partnership that must be set forth in the certificate to the extent that they are applicable, and of these at least seven are always applicable.

The Certificate of Business, Ficticious Name was signed and sworn to by the parties. However, at most it sets forth no more than three of the items of information required to be stated in a certificate of limited partnership. There is no indication in the evidence that it was ever filed in either of the offices specified, and this type of form would normally be filed in only one of them.

The written partnership agreement is not in the form of a certificate. It does, however, contain all of the statutorily required information except the place of residence of each member, if it may be allowed that "Los Angeles" without any other more specific identification is a sufficient statement of the location of the principal place of business. The evidence, however, does not establish that this instrument was ever sworn to and it clearly establishes that it was never filed in either of the offices specified in the statute. (Russell v. Warner (1950), 96 Cal. App. 2d 986 at page 988, 217 P. 2d 43 at page 44)

Under the substantial compliance principle, minor defects in the required procedure may be overlooked under certain circumstances. The showing of compliance with the statute here, is much too meager to be characterized as substantial. It is our conclusion that the partnership formed by Kruglov and Colonna was not a limited partnership under the laws of this state.

Even, however, if it were, there is, in our opinion, a sufficient showing of participation by Kruglov in the operation of the business to cause him to become liable as a general partner under the provisions of Corporations Code section 15507. He devoted substantial time to the business; he made managerial decisions in connection with its operation; he even joined specifically with Colonna in a statement to the Alcoholic Beverage Control Department of a change in their original intent to carry on the business as a limited partnership. Clearly, he took part in the control of the business to an extent that exceeded the rights and powers of a limited partner. (Holzman v. de Escamilla (1948), 86 Cal. App. 2d 858 at page 860, 195 P. 2d 833 at page 834)

Under these circumstances, can it be said that Kruglov did not become liable as a general partner because he contributed capital to the business erroneously believing that he was a limited partner, and that upon ascertaining his mistake he promptly renounced his interest in the profits of the business and other compensation by way of income under the provisions of Corporations Code section 15511? In this regard, we note that Kruglov was by profession an accountant. It speaks poorly of his skill and experience in that profession to say that he erroneously believed that he had become a limited partner in this business. Giving credit, however, to his statement as to his initial belief, the indications of the evidence are almost

overpowering that no such sincere belief could not have survived the incident with the Alcoholic Beverage Control Department in connection with procuring the liquor license for the partnership.

It was more than a year after this incident, and long after many others that should have cast doubt on any such belief before Kruglov "promptly" renounced his interest. In fact, it was more than half a year after the business had ceased operation, and only after an assessment had been made against him by the Department that he so acted.

We are not convinced that Kruglov acted promptly upon ascertaining a mistaken belief, within the meaning of Corporations Code section 15511. However, even if he did, that section offers him no relief from liability as a general partner. This is so because he exercised more than the rights of a limited partner in the operation of the business.

By way of this appeal, Kruglov stresses particularly that taxes have been levied on an estimated basis for a period of time during which the business did not operate. The assessment in this proceeding was made under code section 1126 which expressly authorizes estimation of the amount paid as wages for employment in a period for which no return was filed. Considering the paucity of information available to the Department at the time it made its assessment with no known records extant, the basis of the estimation was not unreasonable.

The records subsequently furnished by the petitioner are incomplete and do not purport to speak for the period during which the petitioner contends the restaurant was not operated. Clearly there was some operation during this period, and it was the petitioner's burden to show just how much. In the absence of convincing proof, we accept the Department's estimation.

Petitioner Kruglov also contends that there has been unequal application of the Department's efforts in pursuing collection against himself as against Colonna. Nothing, however, appears in the record in the nature of any violation of due process of law. That Colonna may also be liable for the assessment in no way means that the Department cannot proceed by way of collection wholly against Kruglov, as long as it in no way releases

Colonna to the jeopardy of Kruglov's rights of contribution against him. Any adjustments due to the fact that Kruglov may be compelled to pay to the Department more than his pro rata share is a matter for subsequent adjustment between Kruglov and Colonna, in which the Department is not involved.

We hold, therefore, that the petitioner Kruglov is liable for the unpaid balancing tax that has been assessed against the partners in Colonna's Cantina under Unemployment Insurance Code section 976.5. He is liable in accordance with the liability of a general partner under the provisions of Corporations Code section 15015. We expressly refrain, however, from making any holding in regard to the moot question of the petitioner's liability for the employer and employee contributions which the petitioner has already paid, since in this proceeding we are without jurisdiction to rule upon the refundability of his payments.

That question can come before us only in another proceeding after a claim for refund has been filed with and denied by the Department, and after a referee has, upon petition, reviewed the denial. In such a proceeding the record presented might differ in some particulars from the one presently before us. Accordingly, it is not appropriate to speak upon what has now become moot here. However, our refraining from doing so should not be construed as meaning that we might or would reach a different decision on these matters on the record before us.

DECISION

The decision of the referee is affirmed.

Sacramento, California, March 16, 1971.

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

ROBERT W. SIGG, Chairman

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CLAUDE MINARD

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